***United States Court of Appeals***

***for the Second Circuit***


# APPELLANT'S BRIEF

# 74-2242

*To be argued by*
ALFRED S. JULIEN

In The

## United States Court of Appeals

For The Second Circuit

NORMAN RICH, SHELDON SCHIFF and HOWARD SCHIFF, as trustees of the West Side Corp. Profit Sharing Plan, SIMON MARGULIES, LOUIS MARGULIES, MARILYN MARGULIES, CHARLES SHURPIN, and LILLIAN SHURPIN, on behalf of themselves and all others similarly situated,

*Plaintiffs-Appellants,*

*vs.*

NEW YORK STOCK EXCHANGE, LADENBURG THALMANN & CO., ARTHUR LEVINE, SOL LEIT, ALLEN SOLOMON and JOEL KUBIE,

*Defendants-Appellees.*

*On Appeal from the United States District Court for the Southern District of New York*

# BRIEF FOR PLAINTIFFS-APPELLANTS

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# PLAINTIFFS-APPELLANTS' BRIEF

## Statement of the Issues Presented for Review

1. Was the court below correct in granting summary judgment to the defendants on the grounds that no cause of action exists in the plaintiffs' favor when the defendants had moved for summary judgment

solely on the grounds that the plaintiffs had no provable damages and the plaintiffs and their counsel made it clear to the court that no evidence going to the merits of the controversy was being submitted and that the plaintiffs had not yet had discovery but that the plaintiffs were directing themselves solely to the issue of showing that provable damages did exist?

2. Was the District Court correct in issuing summary judgment to the defendants where the defendants failed to provide any evidence which could be considered by the court below in support of its findings which granted the defendants summary judgment on the merits of the action?

3. Did the court below properly find, as a matter of law, without any evidence being submitted to it, that the defendant, New York Stock Exchange had properly done all it could to make certain that Weis Securities, Inc. (Weis) was obeying the rules of the Exchange and was not in violation of the net capital requirements?

4. Was the court below correct in finding that the New York Stock Exchange had no actual knowledge of

Weis' financial difficulties prior to mid-April, 1973 and that the Exchange in the exercise of due diligence could not have known of Weis' financial difficulties prior to that time?

5. Assuming arguendo that the second amended complaint did not claim that the Exchange failed to carry out its enforcement of the net capital rules and supervision of Weis prior to being told of Weis' difficulties in mid-April, 1973, should the court below have considered the plaintiff's affidavits, briefs and statements at the oral argument of the summary judgment motion which clearly stated that the plaintiffs were basing their claim on the Exchange's activities prior to the Exchange's actually being told of Weis' difficulties, as an amendment to the plaintiffs' complaint and/or should have permitted the plaintiffs to amend their complaint rather than to enter summary judgment in favor of the defendants?

6. Does the New York Stock Exchange's failure to enforce Weis' compliance with the net capital rules,

which failure was a cause of the plaintiffs' damages, make the Exchange liable to the plaintiffs for those damages?

7. Should the net capital rule, New York Stock Exchange Rule 325, be considered as merely another Stock Exchange rule or should it be considered as a part of the Securities Exchange Act of 1934 for purposes of finding liability for a violation of the net capital rules?

8. After the Exchange has knowledge that a member firm is in a net capital violation, may it permit that firm to continue in business or must it immediately suspend that member firm?

9. Is the Exchange liable for 'tipping' certain large margin accounts to remove their accounts from Weis, prior to Weis' liquidation; if the removal of such accounts was a cause of the plaintiffs damages?

10. Is Ladenburg Thalmann & Co. (Ladenburg) liable to the plaintiffs for aiding certain 'tippee' large margin accounts to remove their accounts from Weis to Ladenburg immediately prior to Weis' liquidation; if the removal of such accounts was a cause of the plaintiffs' damage?

## STATEMENT OF FACTS

### Nature of the Case

This is an appeal from an order of the Honorable Charles L. Brieant, Jr. of the United States District Court for the Southern District of New York, granting the defendant's motion for summary judgment and dismissing the plaintiffs complaint.

The plaintiffs in this action were customers of Weis, a member firm of New York Stock Exchange and various other Exchanges.

The plainciffs NORMAN RICH, SHELDON SCHIFF and HOWARD SCHIFF, as Trustees of the West Side Corporation Profit Sharing Plan, (Rich) were customers of Weis who maintained a brokerage account with Weis on a cash basis. Rich would pay for securities as they were bought, but permitted those fully paid for securities to remain in Weis' vault. Plaintiffs Charles Shurpin and Lillian Shurpin (Shurpin) maintained a margin account with Weis.

Unknown to the plaintiffs, Weis had been in financial difficulties since 1971 and on May 24, 1973, Weis' financial condition had deteriorated to the point where the Securities

Investors Protection Corporation (SIPC) petitioned the Court to appoint a Trustee in order to undertake the liquidation of Weis. Once the SIPC trustee was appointed, all of Weis' customers accounts were frozen and the plaintiffs were unable to obtain or trade in their securities for a substantial period of time.

The plaintiffs were damaged in that they were unable to obtain the monies and securities which were rightfully theirs and in various other ways some of which are set forth in the opinion of the Court below (JA-129a, 141a, 142a).

Sometime between mid-April, 1973 when the Exchange admits that it was informed by Weis that Weis was in severe financial difficulty(Bishop deposition, p. 24-25 ), and May 24, 1973 when the SIPC trustee was appointed to liquidate Weis, the individual defendants together with the Exchange and the defendant Ladenburg had arranged for the transfer of certain large margin accounts from Weis to the defendant Ladenburg (JA-78-a) . These large margin accounts which were transferred out before the SIPC liquidation, took with them many securities which would have remained with Weis and would have been available to the SIPC Trustee

to distribute on a pro rata basis if these large margin accounts had not been 'tipped' and advised to transfer their accounts from Weis prior to May 24, 1973.

The plaintiffs commenced an action against the New York Stock Exchange, Ladenburg Thalmann and four individuals who were the control persons in charge of Weis.

This action was commenced as a Class action on behalf of themselves and all others similarly situated (JA-6a-8a).

The plaintiffs set forth two basic grounds for recovery against the defendants:

1. The plaintiffs allege that they had opened and maintained their accounts with Weis because Weis was a member of the New York Stock Exchange. (JA-10a, 13a). That the Exchange had undertaken, pursuant to a registration statement which it had filed with the Securities and Exchange Commission when it became a recognized Securities Exchange (See 15 U.S.C. 78f), to adequately and properly discipline and police the conduct of its members and would ascertain that its members were obeying the rules and regulations promulgated by the Securities and Exchange Commission and by the Exchange itself.

The plaintiffs claim that since 1971 Weis had been making false and fraudulent entries on its books and for a substantial period of time was in violation of the net capital requirements required by Rule 325 of the New York Stock Exchange.* That the Exchange either knew or should have known of Weis' violation of the net capital requirements yet the Exchange continued to permit Weis to operate until its financial condition deteriorated to the extent that a SIPC liquidation was made necessary and the plaintiffs were caused to be damaged. (See second amended complaint, fifth cause of action, JA-13a. See also 80a, 94a, 95a, 100a, 119a, and 120a).

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* Net capital is the amount of liquid capital which a broker-dealer must maintain as a ratio of debt to capital. The 1934 Act, 15 U.S.C. 78h makes it illegal for a broker to have a ratio of debt to capital which exceeds 20-1. In 1942 the Securities Exchange Commission formulated a net capital rule now found in 17 CFR, § 240.15c 3-1. There was a specific exemption exempting firms who were members of the New York Stock Exchange from the Securities Exchange Commission's net capital rule because the Exchange's rules were allegedly more comprehensive than those of the Securities and Exchange Commission. In recent years, the manner in which the New York Stock Exchange has enforced its own net capital rule has been greatly questioned. Hurd Baruch, former Special Counsel to the Securities Exchange Commission, has authored a well documented study entitled Wall Street; Security Risk (1971) raising grave doubts as to the New York Stock Exchange's enforcement of its own capital rule.

2. The plaintiffs also allege that in mid-April, 1973, once the Exchange was told of Weis' financial difficulties, and net capital violations, the Exchange advised certain large margin accounts of Weis' predicament and that these accounts were transferred to the defendant, Ladenburg as a result of which these favored "tippee" accounts took with them a large amount of securities which were later unavailable to the SIPC Trustee for distribution on a pro rata basis and that since many of these accounts exceeded $50,000.00, which is the maximum protection provided by SIPC (See 15 U.S.C. 78aaa et seq.), if these accounts had not been transferred out, there would have been additional funds and securities available for the plaintiffs and other Weis customers once the SIPC Trustee came in. (See second amended complaint JA-9a through 12a).

Since this action was commenced as a class action, pursuant to Rule 23 of the Fed. R. Civ. P., Civil Rule 11A for the Southern District of New York required that a motion for class action determination be made within sixty days after the filing of the complaint. In order to meet the requirement of Civil Rule 11A, the plaintiffs made a motion to have this action declared a class action.

The defendant Exchange made a cross-motion (JA-28a) for summary judgment on the grounds that there were no genuine issues of material fact that the plaintiffs in this action have no provable damages. Both the plaintiffs' motion for class action determination and the defendants' motion for summary judgment came on to be heard before the Honorable Charles L. Brieant, Jr. on May 21, 1974, and the Court heard oral argument concerning the motions before it. *

On July 22, 1974 the court below decided the motions before it finding that the plaintiffs had provable damages (JA-129a, 141a) but, nevertheless, granted summary judgment to the defendants, dismissing the complaint in this action and declared the class action motion to be moot. (The decision of the court below is found on JA-125a-143a). **

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* A copy of the transcript of the oral argument had before the court below concerning these motions has been provided to this court by stipulation of counsel and is not found in the Joint Appendix. All references in this brief to the transcript of the oral argument will be designated by arg.and the relevant page number.

** The decision of the Court below is also officially reported at379 F.Supp. 1122 (S.D.N.Y. 1974)

## ARGUMENT

### POINT I

SUMMARY JUDGMENT SHOULD NOT HAVE BEEN GRANTED TO THE DEFENDANTS BY THE COURT BASED UPON THE MERITS OF THE ACTION WHERE THE MOVING PARTIES HAD CLEARLY STATED THAT THEY WERE MOVING FOR SUMMARY JUDGMENT SOLELY ON THE GROUND THAT THE PLAINTIFFS HAD NO PROVABLE DAMAGES AND THE PLAINTIFFS AND THEIR COUNSEL MADE IT CLEAR TO THE COURT THAT THE MOTION FOR SUMMARY JUDGMENT WAS BEING OPPOSED SOLELY ON THE GROUNDS THAT THE PLAINTIFFS DID HAVE PROVABLE DAMAGES AND THAT THE PLAINTIFFS HAD NOT HAD AN OPPORTUNITY TO CONDUCT DISCOVERY IN ORDER TO DEFEND A MOTION FOR SUMMARY JUDGMENT BASED UPON THE MERITS.

The defendant, New York Stock Exchange made a motion for summary judgment pursuant to Rule 56 of the Fed. R. Civ. P. based solely on the grounds that "there are no genuine issues of material fact that plaintiffs have no provable damages" (JA-28a). The defendant, Ladenburg relied upon the papers submitted by the Exchange and joined in the Exchange's motion. (JA-71a)

The defendants, taking the position that the plaintiffs had no damages which were provable at law since SIPC had undertaken the liquidation of Weis and that each plaintiff received from the SIPC Trustee the market value of their securities accounts as of May 24, 1973 the date Weis was put into liquidation. In those cases where the plaintiffs' securities were specifically identifiable and available,

the securities themselves were returned to the plaintiff or if the securities were unavailable, the cash value of the plaintiffs' securities was given to the plaintiffs with the valuation being based on the value of those securities on May 24, 1973; the date a SIPC Trustee was appointed. (JA-40a; arg. 30).

The defendants thus took the position that since each plaintiff had received back in either cash or securities, the value of their accounts with Weis as of May 24, 1973, the plaintiffs had suffered no provable damages and that the defendants were, therefore, entitled to summary judgment.

The plaintiffs' claim, however, that despite their receiving from the SIPC trustee in either cash or securities the May 24, 1973 value of their accounts with Weis, they have still suffered damages which are recognizable at law in the following ways, among others:

a) Although the SIPC Trustee did eventually return the plaintiff's cash and securities to them, in many cases this took several months and the plaintiffs were deprived of the use of their money and/or assets for that period. (JA-98a, 104a, 90a)

b) That where the plaintiff had held round lots of securities due to the fact that there was an insufficient

amount of securities available for the SIPC Trustee to distribute, the plaintiffs received back odd lots. (an odd lot is a unit of securities other than a unit of 100 shares). When securities are sold in the securities market, there is an additional fee charged for the purchase or sale of an odd lot of securities (JA-98a, 90a).

c) That where the plaintiffs received back cash instead of securities which had been in their account in order to put themselves into the same position, they were in prior to the SIPC liquidation, the plaintiffs had to pay brokerage fees in order to reacquire securities which they had owned before SIPC's liquidation of Weis.(JA-93a)

d) The SIPC Trustee liquidated some shares held by margin account customers such as the plaintiff, Shurpin (JA-142a), thus causing adverse tax consequences to the plaintiff, Shurpin. (JA-94a).

Both, the defendants who moved for summary judgment and the plaintiffs who opposed the defendants' motion for summary judgment, clearly understood that the summary judgment motion was limited to the single issue as to whether there was any genuine issue of material fact as to whether or not the plaintiffs had provable damages which were recognizable at law.

The defendant Exchange's notice of motion for summary judgment clearly stated that the Exchange was moving -

> "for an order, pursuant to Rule 56 of the Federal Rules of Civil Procedure, granting summary judgment in favor of the Exchange and against plaintiffs on the ground that there are no genuine issues of material fact that plaintiffs have no provable damages." (JA-28a) (Emphasis added)

The affidavit in support of the summary judgment motion by Russell E. Brooks, the attorney for the Exchange, likewise states that the Exchange's motion for summary judgment is being made on the ground that the plaintiffs have no provable damages. (JA-30a)

During the oral argument of the summary judgment motion on May 21, 1974 before the Honorable Charles L. Brieant, Jr. in the court below, Russell E. Brooks the attorney representing the defendant Exchange stated that the motion before the court for summary judgment was based on the single issue that the plaintiffs had no damages which were provable at law. Brooks stating at one point "we purposely avoided the merits in our motion for summary judgment." (arg.22; see also arg. 29) Brooks went on to state:

"Our motion for summary judgment said that the action could not be maintained because there were no provable damages and we stuck to the damages because we thought there was no issue of fact that remained or could be disputed with respect to that." (arg. 23)

The plaintiffs as well as the defendants proceeded to litigate the summary judgment motion brought on by the defendant Exchange with the understanding that the summary judgment motion was limited to the issue of whether or not the plaintiffs had any provable damages.

In the plaintiffs' supplemental memorandum of law, the plaintiffs advised the Court that:

"The merits of this action are not presently on review. A motion for class action recognition does not examine nor go to the merits of the action. The defendants in their motion for summary judgment have rested exclusively on the ground that the plaintiffs have no provable damages. If their motion were based on the merits of this action and as to what certain defendants did nor did not do, there would obviously be a need for the plaintiffs to conduct additional discovery in order to properly respond to a summary judgment motion based upon the merits of this action. The defendants, however, have clearly stated that they are resting their instant motion for summary judgment on the single proposition that regardless of the merits of this action, plaintiffs have no provable damages." (Emphasis added) (JA-109a-110a)

The plaintiffs making it clear that they had not had an opportunity to conduct discovery and were unable to properly respond to a summary judgment motion going to the merits of the action, but were proceeding to oppose the defendant's summary judgment motion with the understanding that the summary judgment motion involved only the single issue of whether or not the plaintiffs had any provable damages.

The plaintiffs and their counsel on many occasions reiterated to the court that it was the plaintiff's understanding that the Exchange was not contesting the merits of the action in its summary judgment motion, but was seeking summary judgment on the limited issue that the plaintiffs had no provable damages. (See the affidavit of plaintiffs' counsel, Alfred S. Julien (JA-86a) and the plaintiffs' memorandum of law in opposition to the defendant's motion for summary judgment.(JA-103a))

During the oral argument of the summary judgment motion before the court below, the plaintiffs made it clear that they were proceeding with the understanding that the only issue before the court brought on by the defendant's summary judgment motion was whether or not the plaintiffs had any provable damages. Counsel for the plaintiff stating to the court during the argument:

"Mind you, your Honor, in this motion for summary judgment, none of these defendants is attacking our major action. They don't say that. All they are saying is there is no damage. That is the same reason they give. No damage. So with respect to the merits of the action, for the purpose of our decision at the present, they seem to assume that is there and it is." (Emphasis added) (arg. 19-20)

During the same argument, plaintiffs' counsel stated to the court:

"They base it upon one point alone. Evidently for the purpose -- I won't make this admission too broad, but for the purpose of this motion, they are admitting that there is a cause of action but all they say the reason there should be summary judgment is because there is no damage." (arg. 16)

On none of these occasions did the court in any way indicate to plaintiffs' counsel that plaintiffs'counsel was somehow mistaken as to the purpose or subject matter of the defendants' summary judgment motion.

Due to the requirements of Civil Rule 11A of the Southern District of New York, which requires that a motion for class action determination be brought on within sixty days after an action is commenced, the plaintiffs promptly made a motion for class action determination which prompted the defendants' cross-motion for summary judgment on the

grounds that the plaintiffs have no provable damages.

At the time the defendants' summary judgment motion was heard by the court below, the plaintiffs had not had an opportunity to obtain discovery and the only discovery which the plaintiffs had had up to that point was a preliminary deposition (54 pages) of Robert Bishop, a Vice President of the Exchange which was held on February 6th, 1974, and which was interrupted by the witness taking an hour and a half intermission to keep a doctor's appointment. The plaintiffs had also obtained from the Exchange copies of the testimony of certain principles of Weis who had given sworn testimony at the Exchange during May of 1973 regarding Weis' financial manipulations.

Subdivision (f) of Rule 56 of the Fed.R.Civ.P. provides that where a party opposing a summary judgment motion advises the court that it cannot at that time oppose a summary judgment motion because the facts essential to justify his position are not then available to him, the court may deny the movant a judgment or order a continuance to permit evidence to be obtained by the party opposing the summary judgment motion. (See also 6, Moore's Federal Practice §56.24)

Counsel for the plaintiffs in this case advised the court that it was unprepared to oppose a summary judgment motion on the merits, and could not do so unless it was given the opportunity to conduct additional discovery, but was opposing the summary judgment motion with the understanding that the issue before the court was the single issue of whether or not the plaintiffs had suffered any provable damages. (JA 109-110a)

It is well settled that summary judgment should not be issued until the party opposing the summary judgment motion has had a fair opportunity to conduct such discovery as may be necessary. See Illinois State Employees Union, Council 34, ETC. v. LEWIS, 473 F2d 561, 565 (7th Cir., 1972) cert. den. 93 S.Ct. 1364, 1370 (1973); Committee for Nuclear Responsibility, Inc. v. Seaborg, 463 F.2d 783,787 (D.C. Cir. 1971); Penn Galvanizing Company v. Lukens Steel Company, 59 F.R.D. 74,80 (E.D.Pa. 1973); Harlem River Consum. Coop., Inc. v. Associated Groc. of Harlem, Inc., 53 F.R.D. 691 (S.D.N.Y. 1971); Erie Technological Prod., Inc. v. Centre Engineering, Inc., 52 F.R.D. 524,529 (M.D.Pa. 1971).

In this Circuit, the court has made it clear that summary judgment sould be sparingly granted in securities fraud cases when little or no discovery has been completed and when, as is the case here, the defendants have exclusive possession of the facts. Schoenbaum v. Firstbrook, 405 F.2d. 215 (2d. Cir. 1968, cert. denied sub nom.; Manley v. Schoenbaum, 89 S.Ct. 1747 (1969); Robinson v. Penn Central Company, 58 F.R.D. 436,440 (S.D.N.Y. 1973) and cases cited therein.

The plaintiffs had not had an opportunity to conduct discovery. Counsel for the plaintiffs had made it clear to the court below that the plaintiffs had not had discovery and could not oppose a summary judgment motion going to the merits of the action because it did not have the necessary facts available to it (JA-109a) and that the plaintiffs were proceeding to oppose the defendant's summary judgment motion with the clear understanding that the sole issue which would be determined by the court was whether or not the plaintiffs in this case had any provable damages. (JA-86a, 110a)

Rule 9(g) of the General Rules of the Southern District in relevent part provides that:

> "Upon any motion for summary judgment pursuant to Rule 56 of the Rules of Civil Procedure, there shall be annexed to the notice of motion a separate, short and concise statement of the material facts as to which the moving party contends there is no genuine issue to be tried."

The purpose of the Rule obviously being to let the parties to the motion know precisely which facts the moving party contends are not in issue. The party opposing the motion for summary judgment will thus know what to direct its efforts to and which issues the moving party claims are not in dispute. In this case, although the Exchange while moving for summary judgment did not comply with Rule 9(g) and submit a concise statement of which facts it contended were not in dispute, it stated in its notice of motion (JA-28a and in the supporting affidavit of Russell E. Brooks (JA-30a) that the only issue as to which it contended there was no genuine issue of material fact, was the issue of the plaintiffs having provable damages in this case.

The plaintiffs also understood this to be the sole issue which the court was to determine on the summary judgment motion and directed its efforts in its affidavits

and memoranda of law to opposing the motion by showing to the court that the plaintiffs did have provable damages (See the affidavits of Alfred S. Julien (JA-79a), Charles Shurpin (JA-89a) and Sheldon Schiff (JA-97a) and plaintiffs memoranda of law (JA-102a and JA-109a) which are all directed to the single purpose of showing to the Court that the plaintiffs do have provable damages.

A party in order to intelligentl y oppose a motion for summary judgment must have notice of the grounds upon which the moving party claims it is entitled to summary judgment. Here, the defendants based their claim for summary judgment on the fact that the plaintiffs had no provable damages. The court below in deciding the summary judgment motion conceded that the plaintiffs did suffer damages which were provable at law. (JA-129a, 141a, 142a) Plaintiffs, however, to paraphrase Judge Kaufman's language in this Court's decision in Jaffee & Company v. Securities and Exchange Commission, 446 F.2d 387,394 (2d Cir.,1971), were in the unenviable position of having won the battle but lost the war, theyhad no reason to know they were waging on a battlefield theyhad never entered.

The sole issue before the court below on the defendant's motion for summary judgment was whether or not the plaintiffs had suffered provable damages. This was the understanding of both the plaintiffs and defendants in submitting evidence in support of and in opposition to the motion. See (JA-28a, 30a, 103a, 109a; arg. 19-20, 22, 23 and 29). The court below after finding that the plaintiffs had suffered provable damages (JA-129a, 141a) went on to grant the defendants their motion for summary judgment on an issue in support of which the defendants had submitted no evidence as required by Rule 56 of the Fed.R.Civ.P.; and in opposition to which the plaintiffs were unaware that any evidence was required to be submitted in opposition to and which the plaintiffs were unable to submit evidence in opposition to because they had not yet had discovery.

The court below erred in granting the defendants' motion for summary judgment on the merits of this action when that issue was not before it and the plaintiffs had clearly advised the court below that they were proceeding with that understanding.

## POINT II

ASSUMING ARGUENDO THAT THE COURT DID HAVE THE ENTIRE CASE BEFORE IT, RATHER THAN JUST THE ISSUE OF DAMAGES ON THE DEFENDANTS' MOTION FOR SUMMARY JUDGMENT, SUMMARY JUDGMENT SHOULD STILL HAVE BEEN DENIED BY THE DISTRICT COURT BECAUSE THE MOVANT HAS FAILED TO MEET ITS BURDEN UNDER RULE 56(c) of the Fed.R.Civ.P. OF INITIALLY SHOWING BY PROPER EVIDENTIARY MATTER THAT THERE WAS NO GENUINE ISSUE OF MATERIAL FACT IN THIS CASE.

The defendant, Exchange in its motion for summary judgment submitted the affidavits of Russell E. Brooks, one of the attorneys for the Stock Exchange and the affidavit of James W. Giddens, an attorney with the firm of Hughes, Hubbard & Reed, counsel to Edward Reddington the SIPC Trustee. (JA-28a, 38a). Aside from these two affidavits, the defendant, Exchange and the defendant, Ladenburg, who relied upon the Exchange's materials in support of its own motion for summary judgment (JA-71a) submitted no additional affidavits by any persons having knowledge of the facts at issue in this case. Nor did they provide any other proper evidentiary material, in support of their summary judgment motion aside from their advising the Court that it was relying upon the pleadings had in the action. (JA-28a)

Since the party moving for summary judgment has the burden of establishing by proper evidentiary matter the absence of a genuine issue of material fact in order for a motion for summary judgment to be granted in its favor, the defendants' failure to provide any proper evidentiary material whatsoever except for the affidavits of the two attorneys as aforesaid was insufficient to meet their burden of establishing by proper evidentiary materials the absence of a genuine issue of material fact and the court below erred in granting summary judgment to the defendant when they had not met their burden of proof as required by Fed.R.Civ.P. Rule 56(c).

The court below in its decision on numerous occasions regarding the factual issues in this case, e.g. whether or not the defendant Exchange had knowledge that Weis was facing financial difficulties prior to April of 1973, states that the plaintiffs have come forward with no evidence to the contrary, i.e., to show that the Exchange did or should have had knowledge prior to April, 1973 that Weis was in financial difficulty. (JA-127a)

In its decision (JA-129a) the court finds that "upon uncontested facts and evidence presented in affidavits on this motion and the depositions, no cause of action exists in the plaintiffs favor." The court goes on to state that the plaintiffs have not alleged that the Exchange had knowledge of Weis' financial difficulties prior to the middle of April, 1973, (JA-134a) and, according to the court, the plaintiffs are basing their claim only on the Exchange's actions after it was actually told of Weis' difficulties in mid-April, 1973. (JA-134a)

The court below also found (JA-138a) that the plaintiffs have presented no evidence to support any inference that the transfer of large margin accounts out of Weis prior to its liquidation was improper. The court went on to find that the plaintiffs could not recover because on the motion for summary judgment they had offered no evidence to show that the Exchange's action was a proximate cause of the plaintiff's damages. (JA-138a)

The plaintiffs take the position that there was sufficient evidence before the court to advise the court that the plaintiffs were basing their claim on the actions or inactions of the Exchange commencing in 1971 when Weis'financial difficulties first began and Weis began manipulating its books so that it would meet the net capital requirements. See(arg. p.5; JA-43a, 80a, 94a, 100a, 118a, and 120a) See also the decision of the Court (JA-139a) where the Court below stated that its determination in this case was without prejudice to the plaintiff's actions in the related case of Rich v. Touche Ross & Co. 74 Civ. 772-CLB where the plaintiffs claims were against Weis auditors for failing to properly audit Weis' books and records between January, 1971 and May, 1973.

The court below was thus fully aware that the plaintiffs claims were based upon the Exchange's actions from 1971 through May 24, 1973 and were not limited to the Exchange's actions after mid-April, 1973 as found by the Court in its decision (JA-134a, 138a).

Although the plaintiffs did produce evidence on the motion for summary judgment which negated the findings of fact as found by the Court and which did show that there were material issues of fact to be tried at a trial of this action, assuming arguendo that the plaintiffs had offered no proof at all in opposition to defendant's motion for summary judgment, summary judgment should not have been granted to the defendants because the defendants had failed to carry their initial burden of proof as required by Fed.R.Civ.P., rule 56(c) to show by proper evidentiary materials that there were no genuine issues of material fact.

Fed.R.Civ.P. 56(c) in relevant part provides as follows:

> "The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

The party seeking summary judgment must produce proper evidentiary matters in support of its motion to show that there is no genuine issue of material fact for the Court to determine at a trial. The Advisory Committee notes to the 1963 amendment of Subdivision (c) of Rule 56 states:

> "Where the evidentiary matter in support of the motion does not establish the absence of a genuine issue, summary judgment must be denied even if no opposing evidentiary matter is presented."

In Adickes v. S.H. Kress & Co., 90 S.Ct. 1598 (1970), the court reversed the Circuit Court's affirmance of the District Court's granting of a summary judgment motion to a defendant because the defendant had not met its burden of proof of satisfactorily establishing that there was no genuine issue of material fact, although the plaintiff in Adickes had not come forward with any proof to contradict certain allegations which the defendant had made in support of its motion for summary judgment.

The court citing the Advisory Committee's notes on the 1963 amendment to subdivision (c) of Rule 56 made it clear that it is the burden of the party moving for summary

judgment to initially show by proper evidentiary material, the absence of a genuine issue concerning any material fact and stated that where the movant had not met its initial burden, the petitioner did not have to come forward with any opposing affidavits or other evidence and the motion for summary judgment should be denied. In the absence of the party moving for summary judgment discharging the burden put upon him, he is not entitled to judgment and no defense is required by the party opposing the motion for summary judgment where the moving party has not met its initial burden. (90 S.Ct. at 1609-1610) See also (6 Moore's Federal Practice, IP. 56.22 (2).

In the Exchange's motion for summary judgment, there was no proper evidentiary material available to the court below upon which it could base its summary judgment only. The only material available to it were two affidavits submitted by attorneys. One by Russell E. Brooks, an attorney for the Exchange (JA-30a) and the other an affidavit

by an attorney for SIPC (JA-38a). Subdivision (e), of Rule 56 provides that on a motion for summary judgment:

> "Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein."

Affidavits submitted by attorneys for a party should not be considered except insofar as they are based upon personal knowledge. The affidavit of Russell E. Brooks the attorney for Exchange contains no statements as to the factual issues in this litigation and Russell E. Brooks does not pretend to have any personal knowledge as to the factual issues of this litigation. The Brooks affidavit can, therefore, in no way support the defendant's motion for summary judgment. This Circuit has made it clear that attorneys' affidavits, except those made upon matters as to which the attorney has personal knowledge should not be considered by a court on a motion for summary judgment. Union Insurance Soc. of Canton, Ltd. v. William Gluckin & Co., 353 F.2d 946 (2d Cir. 1965). See also McSpadden v. Mullins, 456 F.2d 428,430 (8th Cir. 1972). Counsel for the Exchange

was aware of the fact that a motion for summary judgment required admissible evidentiary facts in support of it. In fact, counsel for the Exchange cited Union Insurance Society of Canton, Ltd., supra in its memorandum of law submitted to the court below. (JA-47a)

The affidavit of James W. Giddens, the attorney for the SIPC Trustee also does not deal with the factual issues i.e., the activities and actions of the defendant Exchange in its policing and supervision of Weis between 1971 and May 24, 1973 and the actions of the defendants, Ladenburg and the Exchange in 'tipping' certain large margin accounts to remove their accounts from Weis prior to Weis being placed in a SIPC liquidation on May 24, 1973.

The court below, aside from the pleadings in this action had before it no evidence at all which was admissible and should or could be considered by a court on a summary judgment motion pursuant to the requirements of Rule 56 (c) and (e).

Having no admissible and proper evidence before it upon which it could base its granting of a summary judgment motion, the court below relied upon improper materials as a basis for granting the motion for summary judgment. In its decision (JA-128a) the court on two occasions relies on page 9 of the defendant Exchange's brief in order to substantiate its findings to grant summary judgment. The cases are consistent in holding that a brief or a memorandum of law is not evidentiary matter which Fed.R.Civ.P. Rule 56 authorizes and requires to be submitted and which may be considered by a court on a motion for summary judgment. See United States v. Malkin, 317 F.Supp. 612, 614 (E.D.N.Y. 1970).

Garza v. Chicago Health Clubs, Inc., 347 F.Supp. 955,964 (N.D.Ill.1972); Weiss v. Kay Jewelry Stores, Inc., 470 F.2d 1259, 1267 (D.C. Cir. 1972). See also 6 Moore's Federal Practice, IP. 56.11 (1.-8) and the cases cited therein. The court below (JA-133a) specifically states that it is relying on the briefs submitted in support of the defendant's motion for summary judgment. This is error.

Briefs are not evidentiary material and should not be considered by the court in support of a motion for summary judgment.

In addition to relying upon the briefs of the moving parties in support of their motion for summary judgment, the court below relied upon and quoted extensively from a letter written by the Director of the Securities and Exchange Commission's Division of Market Regulation to a member of Congress from the District in which the plaintiff Shurpin resides, which was a response to a letter sent by the Congressman to the Securities and Exchange Commission after the plaintiff Shurpin asked him to inquire into the situation regarding Weis' liquidation and the transfer of large margin accounts from Weis immediately prior to the liquidation.

The court in its decision (JA-135a-136a) quotes extensively from the letter to the Congressman in support of its finding that the Exchange's transfer of large margin accounts from Weis immediately prior to Weis' liquidation

was a proper practice and did not injure the plaintiffs. Letters such as the one extensively quoted from by the court below are the rankest type of hearsay material which should not be considered by a court on a summary judgment motion.

The court below, in its decision granting summary judgment to the defendants(JA-136a) also relies upon a letter sent to the court by counsel for the Exchange (the letter is found on JA-77a-78a). The court relies upon that letter for the proposition that a member firm must reduce its business as it approaches a point where it might be in a violation of the net capital requirements.

Inherent in the court's finding are two propositions which are inimical to the plaintiffs' position. a) The inherent finding that the Exchange acted properly in attempting to aid a member firm in conforming to the net capital requirements and that the Exchange had no ulterior motives in doing so both of which are questions for the jury; and b) that Weis was not already <u>in</u> net capital violation when these large margin accounts were transferred

out of Weis. It is the plaintiff's position that Weis had been in violation of the net capital requirement for a substantial period of time prior to April of 1973 since sometime in 1971. Once a firm is in net capital violation, the Exchange cannot permit the firm to continue in business until it is properly capitalized. That the Exchange's own constitution requires immediate suspension (See Article XIII, §2 Constitution of the New York Stock Exchange; CCH, N.Y.S.E. Guide, Vol. II, IP 1602); in addition since 15 U.S.C. 78h makes it unlawful for any broker to continue in business where its percentage of debt to capital exceeds 20 to 1, the Exchange by permitting Weis to remain in business after Weis was in net capital violation was aiding and abetting a violation of §8 of the 1934 Act.

The letters upon which the Court relied so heavily on in its findings in issuing summary judgment for the defendants, are not the type of material which is specified in Rule 56 and which may be considered on a motion for summary judgment. The cases hold that letters which are not under oath and which in this case were pure hearsay, should not be considered by a court on a summary judgment motion.

Woodbury v. McKinnon, 447 F.2d 839, 845 (5th Cir. 1971); Blum v. Campbell,355 F. Supp. 1220, 1227 (D.Md. 1972).

The court below, in issuing summary judgment for the defendants also relied heavily upon the deposition of Robert Bishop, a Vice-President of the Exchange (See pages JA-127a, 133a-134a). The Bishop deposition was a preliminary deposition taken by the plaintiffs which was interrupted for one and a half hours by Bishop's doctor's appointment and which purpose was solely to obtain, primarily, information as to the persons involved in overseeing Weis on behalf of the Exchange. All parties were aware when the Bishop deposition was adjourned, that it had not been completed and that a complete in depth deposition would take place at a later date. In fact, when plaintiff's counsel requested that Bishop sign that portion of his deposition which had been transcribed, plaintiffs' counsel received a letter from counsel for the Exchange dated April 4, 1974, (Annexed as Exhibit "A" to this brief), which stated "in view of the fact that the deposition has not been completed, we believe it would be improper to have Mr. Bishop execute the transcript at this time."

There was, thus, no question that the Bishop deposition was incomplete,had not been signed and should not have been relied on by the court below as providing any evidence at all in support of the defendant's motion for summary judgment.

Rule 30 of the Fed.R.Civ.P., subdivision (e) states in pertinent part:

> "The deposition shall then be signed by the witness, unless the parties by stipulation waive the signing . . ."

The parties had not consented to or stipulated to waive the signing of the Bishop deposition. A deposition which has not been signed and is admittedly incomplete, should not be considered by the court as evidence which may properly support a motion for summary judgment. See Blum v. Campbell, 355 F.Supp. 1220,1227 (D.Md. 1972)

The court in its decision also relies upon statements made by counsel for Ladenburg to the court during the oral argument of the motion, (JA-143a) to support the proposition that Ladenburg had merely been a good samaritan in agreeing to accept the large margin accounts from Weis immediately prior to Weis' liquidation. The court goes on to rely upon unsworn representations, and concededly not upon personal knowledge, made by counsel for Ladenburg during the oral argument to support the proposition that Ladenburg allegedly suffered damages by virtue of its good samaritan role.

There has been no evidence at all as to Ladenburg's real motives in taking over these large margin accounts and not an iota of evidence to support the court's finding that Ladenburg had suffered damages by virtue of taking over these large margin accounts. Rule 56 does not permit a court to take into consideration much less draw inferences from, unsworn hearsay statements made by counsel for a party moving for summary judgment in support of a motion for summary judgment. See Weiss v. Kay Jewelry Stores, Inc., supra and Garza v. Health Clubs, Inc., supra.

The court below in granting summary judgment to the defendant did so despite the fact that the defendants had failed to provide any evidence at all as to the factual issues in this case. In those findings of fact which it did make in its decision granting summary judgment to the defendants, it relied upon materials which are inadmissible in evidence and should not be considered by a court on summary judgment motions. The court below in order to grant summary judgment to the defendants, necessarily had to rely upon these improper materials because the defendants had failed to provide any admissible evidence at all in support of their motion for summary judgment.

## POINT III

SUMMARY JUDGMENT SHOULD NOT BE GRANTED WHERE THERE ARE ISSUES OF FACT REMAINING TO BE TRIED. THE COURT SHOULD LIBERALLY CONSTRUE THE PAPERS PRESENTED BY THE PARTIES OPPOSING SUMMARY JUDGMENT AND WHERE FACTS APPEAR IN THE PAPERS OF A PARTY OPPOSING SUMMARY JUDGMENT WHICH WOULD JUSTIFY AN AMENDMENT TO THE PLEADINGS, SUCH AN AMENDMENT TO THE PLEADINGS SHOULD BE DIRECTED BY THE COURT AND SUMMARY JUDGMENT SHOULD NOT BE GRANTED.

The purpose of a motion for summary judgment is not to try issues of fact but only to determine whether there are issues of fact to be tried. Once the Court has determined that there are issues of fact to be tried, it must leave those issues for determination at the trial of the action. See Empire Electronics Co. v. United States, 311 F.2d 175, 179 (2d Cir. 1962). In this case there are issues of fact which should be determined by a jury and should not have been determined by the court below on a motion for summary judgment.

The plaintiffs claim in this case that the defendant, Exchange improperly supervised and policed Weis, a member firm of the Stock Exchange as the Exchange had undertaken to do in its registration statement filed with the Securities and Exchange Commission pursuant to 15 U.S.C. 78f.

The plaintiffs allege that since 1971 Weis had manipulated its books and records so as to conceal its true financial condition and to give the appearance that it was in compliance with net capital requirements. If the Exchange did not have actual knowledge of Weis' activities prior to April, 1973; if it had properly carried out its duties of policing and disciplining Weis, it would have discovered long before mid-April, 1973 that Weis was in violation of the net capital requirements; that Weis' books and records were fraudulent and not have permitted Weis to carry on business as a broker-dealer. Such action by the Exchange would have prevented Weis' condition from deteriorating to the extent that a SIPC liquidation would become necessary, with all of its attendant consequences to the plaintiff. (JA-80a, 94a, 95a, 100a, 119a, 120a, 13a, arg.5)

The Exchange in its answer (JA-18a) admits that from April, 1971 Weis' books were false and fraudulent and that Weis was in violation of the net capital requirements. The Exchange also admits (JA-43a) that they understood this to be the plaintiff's theory of liability at the time the summary judgment motion was heard by the court.

The plaintiffs also claim (Fourth Cause of Action Second Amended Complaint (JA-12a), that they were the third party beneficiaries of the registration statement filed by the Exchange with the Securities and Exchange Commission and as such are entitled to recover from the Exchange for its failure to properly supervise Weis on a contractual theory as set forth by the court in Weinberger v. New York Stock Exchange, 335 F.Supp. 139 (S.D.N.Y. 1971)

For a complete and separate complaint against the defendants, the plaintiffs allege that once the Exchange was told in mid-April, 1973 that Weis was in financial difficulty and was in violation of the net capital rules, it helped and agreed to transfer out certain large margin accounts to the defendant Ladenburg. Those favored persons were no longer customers of Weis on May 24, 1973 when the SIPC liquidation took place and as a consequence of which the plaintiffs suffered various damages. (arg. 5 to 6, JA-80a,81a) The court below in its decision, although recognizing that the plaintiffs were claiming that the Exchange failed to properly supervise Weis and that this failure had brought about the necessity of a SIPC liquidation (JA-126a) somehow, later on in its decision, reaches a conclusion based solely upon the

unsigned and uncompleted deposition of Robert Bishop (JA-133a) that the Exchange could not, through the exercise of reasonable diligence, have learned of Weis' net capital violations until mid-April, 1973. Despite the fact that there was no evidence at all submitted to the Court by the defendants to support this proposition.

The plaintiffs, of course, claim that the Exchange was or should have been on notice as early as 1971 that Weis was having net capital difficulties. (arg. 5-6)

The court goes on to find (JA-134a) that the plaintiffs have not alleged that the Exchange had actual knowledge of Weis' difficulties prior to April, 1973 or that with due diligence the Exchange could have known of Weis' difficulties prior to April, 1973. The court in defiance of the plaintiff's express statement (JA-120a) (arg.5) goes on to find that plaintiffs are basing their claims only on the defendants' actions after actually being told of Weis' difficulties in April, 1973.

The plaintiffs have expressly stated (arg. 5,6) (JA-120a) time and time again, that they were basing their claim on the fact that the Exchange had failed to properly supervise Weis since 1971 and that it was this failure that

permitted Weis' financial condition to deteriorate to the point where a SIPC liquidation would become necessary. (JA-120a, 80a, 94a, 100a) On two of these occasions, the plaintiff specifically stating that they were basing their claim on the Exchange's failure to adequately police Weis since April, 1971. (arg. 5 and JA-120a)

In addition, this Court was aware of a companion case entitled Rich v. Touche Ross & Co., 74 Civ. 772-CLB (JA-139a) where the Court in its decision stated that it understood the plaintiff's actions against Touche Ross to relate to the activities of Weis' auditors between January, 1971 and May, 1973.

Plaintiffs cannot understand why the court below found that although the plaintiffs were aware and the defendant, Exchange admitted (JA-43a) that Weis had fraudulent books and was in net capital violation since 1971, the plaintiffs were somehow seeking to hold the Exchange accountable only for its activities after April, 1973. The court, in essence, finding that the plaintiffs for some reason weredetermined to proceed with an inadequate rather than with a viable claim against the defendant Exchange. Fed.R.Civ.P.8(f) instructs us that "all pleadings shall be so construed as to do substantial justice". The plaintiffs' pleadings should have been so construed.

Even if the year 1971 does not appear in the plaintiff's second complaint, the plaintiffs and their counsel put the court on notice that their action was based upon the Exchange's activities from 1971 onward. (JA-120a, arg. 5-6).

It has always been the rule in this Circuit that where facts appear upon a motion for summary judgment which would justify an amendment of the pleadings and such an amendment would make the granting of summary judgment improper, the amendment of the complaint should be permitted and summary judgment should not be entered. Rossiter v. Vogel, 134 F.2d 908, 912 (2d Cir. 1943).

The Fifth Circuit has taken the same position. Where a plaintiff has advanced a theory to the court which would save his complaint, the court should either consider the complaint as having been amended or the plaintiff should be given an opportunity to amend the complaint and summary judgment should not be granted. See Sherman v. Hallbauer, 455 F.2d 1236,1242. (5th Cir. 1972) See also 6 Moore's Federal Practice, IP56.10.

Even if the Court did read the plaintiff's second amended complaint (JA-134a) as pleading a claim based only upon the defendant's activities after April, 1973, the court below was made aware by the plaintiff's affidavits and argument that their claim was based on the period from 1971 onward. The court below should have permitted or directed the plaintiff to amend their complaint rather than to grant summary judgment to the defendants.

On a motion for summary judgment, the Courts should be critical of the papers presented by the moving party but should construe liberally the papers submitted in opposition to the motion for summary judgment. Wittlin v. Giacalone, 154 F.2d 20, 21 (D.C.Cir. 1946).

Any doubts as to the existence of a genuine material issue of fact, must be resolved in favor of the party opposing the motion for summary judgment. If reasonable minds can draw different inferences and conclusions from the facts offered, summary judgment should not be granted. Harvey v. Great Atlantic & Pacific Tea Co.,

388 F.2d 123,125, (5th Cir.1968) a Judge may not on a motion for summary judgment draw factual inferences. Bragen v..Hudson County News Co., 278 F.2d 615,618 (3rd Cir. 1960).

In this case, plaintiffs had demanded a trial by jury (JA-6a) and it was a question for the jury to determine as to whether or not the Exchange did or could have known of Weis' violation of the net capital requirements prior to April, 1973 when admittedly Weis advised the Exchange of its financial problems.

There was no evidence presented to this court aside from the self serving statements in the unsigned Bishop deposition that the Exchange could not have known of Weis' financial difficulties before April, 1973. In fact, all the facts which are available to the plaintiff indicate that it was only through gross negligence and failure to properly supervise Weis that the Exchange could have been unaware of Weis' financial manipulations between 1971 and 1973. A complaint filed by the Securities and Exchange Commission against certain of Weis' officers in the United

States District Court for the Southern District of New York, (73 Civil 2322), alleges that since April of 1972 there had been manipulations of Weis' books and records and that Weis had been in violation of the net capital requirements. (SEC complaint, par. 28). Similarly, a criminal indictment filed in the Southern District of New York by the United States attorney 73 Crim. 693 against certain officials of Weis likewise states that since March, 1972, Weis was having net capital difficulties. (Par. 5 of the indictment)

Testimony taken by the Exchange itself, during May of 1973, of certain persons employed by Weis supports this. Robert Lynn, a staff accountant with Weis testified that in February of 1973 Weis received a telephone call from William Shields at the Exchange advising Weis that Weis was on the Exchange's watch list. (Lynn testimony, p.84 May 14, 1973)

Without having had an opportunity to refer to the Exchange's and Weis' documents, merely by looking at public records, it becomes obvious that in light of Weis' extreme and outrageous fraud, where approximately four million dollars

in fraudulent entries appear on Weis' books(Indictment 73, Crim. 693,p.12) that the Exchange if it did not know of Weis' financial condition should have become aware of it if it had properly audited and policed Weis. The Exchange admits (Bishop's deposition, pages 14, 26)that it has a right to audit its member firms and that it did audit Weis between 1971 and 1973. The Exchange's failure to discover these huge discrepancies in Weis' books and records leaves a question for a jury as to whether or not the Exchange carried out its auditing and policing activities properly.

On a motion for summary judgment, the plaintiff is not bound to prove its case but only has to show that it possibly has a case. Gutor International Ag. v. Raymond Packer Co., Inc. 493 F.2d, 938,944 (1st Cir. 1974). Here, the plaintiff had presented at least an issue of fact which was to be determined by a jury as to whether the Exchange supervised Weis properly or not. There was no evidence submitted on behalf of the Exchange's summary judgment motion to indicate that the Exchange could not have discovered Weis' derelictions if it had properly carried out its supervisory activities.

Similarly, the Court's finding that the transfer of large margin accounts from Weis to Ladenburg was not improper(JA-138a) was error.

There was not a shred of evidence submitted by the Exchange or Ladenburg in support of the summary judgment motion to indicate how many accounts had been transferred from Weis to Ladenburg, the nature of the accounts and whom they belonged to. The court's finding (JA-138a) that the Exchange had aided the transfer of these accounts from Weis to Ladenburg in order to protect the public interesthas absolutely no support at all.

In a very similar situation in Kinzler v. New York Stock Exchange, 62 F.R.D. 196 (S.D.N.Y. 1974) a registered representative of a failing brokerage house brought an action against the Exchange for a freeze it had imposed prohibiting other brokers from employing the failing broker's registered representative for a period of time. The Exchange moved for summary judgment urging that it had invoked the 'freeze' in order to protect the public.

Judge Gurfein then sitting in the Southern District, stated that although it might turn out to be the fact that the Exchange had acted solely in order to protect the public since the plaintiff raised the possibility that it had been its intent to favor another broker, he Had raised issues of fact which precluded the Exchange from obtaining summary judgment. (62 F.R.D. at 202)

In Robinson v. Diamond Housing Corporation, 463 F.2d, 853 (D.C.Cir. 1972) the defendant moved for summary judgment on the grounds that the actions complained of by the plaintiff had been done by him for a legitimate reason. The court there found that the mere existence of a legitimate reason for certain actions would not insulate the defendant from liability if the jury believed the plaintiffs' claim that the defendant, in fact, had been motivated by an illigitimate reason. (463 F.2d at 867)

Similarly, in our case, it was a question for the jury and not for the court below to decide on a summary judgment motion as to whether or not the Exchange had aided the transfer of large margin accounts from Weis to Ladenburg in order to protect the public or whether the Exchange did so to aid certain favored accounts

in avoiding the forthcoming SIPC liquidation of Weis with all its attendant consequences.

The court below thus erred in deciding questions of fact which should have been left for the jury at a trial of this action.

## POINT IV

### THE DEFENDANT EXCHANGE IS LIABLE TO THE PLAINTIFFS FOR ITS FAILURE TO FULFILL ITS STATUTORY OBLIGATION OF PROPERLY SUPERVISING AND DISCIPLINING WEIS, A MEMBER FIRM OF THE EXCHANGE.

The Exchange is a registered exchange pursuant to §6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f).

After Baird v. Franklin, 141 F.2d 238 (2d Cir. 1944) (cert. denied 65 S.Ct. 38) (1944), there is no longer any question that a private right of action exists against the Exchange for the failure to fulfill its statutory obligations of properly supervising and disciplining its member firms.

The court below in its decision (JA-130a) cited Baird and then went on to find, without any evidence at all being submitted by the defendants in support of the court's findings that because the Exchange has 579members who employ approximately 56,000 registered representatives,

the Exchange had properly carried out its responsibilities of supervising and policing Weis under the adage that "no sheriff can prevent all felonies in his bailiwick, and the law does not so require." (JA-131a-132a)

In support of its finding, the Court cited Marbury Management, Inc. v. Kohn, 373 F.Supp. 140 (S.D.N.Y. 1974) and Hochfelder v. Midwest Stock Exchange, 350 F.Supp. 1122, (S.D.Ill. 1972). Both of these cases are inapposite to the case at bar. Marbury was a situation where an individual registered representative had defrauded certain customers of a brokerage firm. The court, there found that the Exchange had done all it could to properly supervise the brokerage firm and its registered representatives and granted summary judgment for the Exchange. In Marbury, however, the Exchange's motion for summary judgment was supported by affidavits and other documentary evidence showing what actions the Exchange had taken to supervise the broker and representative in question, and the plaintiff in that case had had an opportunity to submit

evidence in opposition to the defendant's motion. Similarly, in Hochfelder, the court held that the Exchange would not be held liable merely on the grounds that it had issued a plaque to a member of the Exchange which indicated to the public that the member would adhere to the principles of fair trade adopted by the Exchange. When the broker embezzled customer's funds, the court held that the Exchange would not be held liable. Here too, the summary judgment motion was supported by proper admissible evidence and the plaintiff had an opportunity to gather and to submit evidentiary material in opposition to the summary judgment motion.

In our case, we are not dealing with the derelictions of a single registered representative but rather with a colossal fraud involving millions of dollars and continuing for a period of several years by one of the Exchange's larger member firms with over 35,000 customers. If the standard to be applied by the courts

in determining when the Exchange should be liable for a failure enforce the supervisory duties it had undertaken is to be that of negligence as the court below found it was (JA-133a) see also Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963) which applies the negligence standard to an action brought against the Exchange for its failure to properly carry out the duties it had undertaken pursuant to §6 of the Securities Exchange Act of 1934. It was a question for a jury to determine whether or not the Exchange's failure to discover Weis' financial difficulties prior to April, 1973 was due to the negligence of the Exchange or to Weis' expertise at committing fraud. It was not a question which should have been determined by the court below on a motion for summary judgment.

The court below in its decision (JA-132a) refers to the touchstone set out by Judge Friendly in Colonial Realty Corporation v. Bache & Co., 358 F.2d 178 (2d Cir. 1966) (cert. denied, 385 U.S. 817) (1966) in reaching

a conclusion that in order to hold the Exchange liable for failing to enforce the Exchange's net capital rule, the plaintiff also had to prove a fraud claim against the Exchange. (JA-133a)

The test set out in Colonial with regard to whether or not there should be liability for violation of stock exchange rules is inapplicable to our case. In our case, the plaintiffs claim that Weis had been in violation of exchange Rule 325, a net capital rule. Rule 325 is not just another exchange rule but is a substitute for a specific SEC regulation, 17 C.F.R. §240.15 c3-1. For the purpose of finding liability for a violation of the capital rules, a violation of Rule 325 should be considered as a violation of a SEC regulation and not simply a violation of another stock exchange rule. The court in Colonial indicated that it had this analysis in mind when it suggested its test for determining whether or not liability should be had for the violation of an exchange rule. See 358 F.2d at 182.

It is a question for a jury as to whether or not the Exchange properly carried out its supervisory duties in making certain that Weis was not in net capital violation between 1971 and May 24, 1973, or if the Exchange was negligent in failing to properly ascertain that Weis was in compliance with the net capital requirements.

In a note in the Columbia Law Review entitled "Exchange Liability For Net Capital Enforcement", 73 Col.L. Rev. 1262 (1973) the author points out that although the New York Stock Exchange has been abjectly negligent in failing to enforce the net capital rules the courts have been reluctant to compel the Exchange to either properly carry out the duties it undertook or to hold it liable for a failure to do so. The author suggests at the conclusion of the article that if the Exchange were held liable for its failure to properly carry out its duties to enforce its compliance with the net capital requirements, the Exchange would take its duties a lot more seriously.

In light of Weis' colossal fraud and for the period of time over which it extended, it is unbelievable

that the Exchange, if it had properly carried out its duties,was not aware of Weis' net capital violations prior to mid-April, 1973. The court below in finding that the Exchange did not and could not, in the exercise of due diligence, discover Weis' net capital violations prior to April, 1973, (JA-134a) is unsupported by any evidence submitted to it by the defendants in their motion for summary judgment and summary judgment should not have been granted to the defendants where a genuine material issue of fact existed as to the Exchange's negligence in failing to discover Weis' net capital violations between 1971 and mid-April, 1973.

## POINT V

### IF THE DEFENDANTS 'TIPPED' CERTAIN LARGE MARGIN ACCOUNTS TO TRANSFER THEIR ACCOUNTS OUT OF WEIS PRIOR TO THE SIPC LIQUIDATION AND THIS WAS A CAUSE OF DAMAGE TO THE PLAINTIFFS, THE DEFENDANTS ARE LIABLE TO THE PLAINTIFFS.

It is conceded by all sides that certain large margin

accounts were transferred from Weis to the defendant Ladenburg and that the Exchange knew of and aided in the transfer of these large margin accounts. These accounts were transferred from Weis prior to May 24, 1973 and they were no longer customers of Weis when the SIPC Trustee was appointed to liquidate Weis on May 24, 1973 with all of the attendant consequences for the plaintiffs and other Weis customers.

The court below found (JA-138a ) that this was a proper action on the part of the defendants and was done solely to protect the public interest. In addition, the court below found (JA-138a ) that the defendants were not liable to the plaintiffs because the defendants were not the proximate cause of the plaintiffs' damage.

In Shapiro v. Merrill Lynch Fenner Pierce & Smith, Inc., 495 F.2d 228 (2d Cir. 1974) this court held that there should be no distinction between non-trading 'tippers' and trading 'tippees' 495 F.2d at 237. If the defendant Exchange and Ladenburg 'tipped' certain

large margin accounts to remove their accounts from Weis prior to the SIPC liquidation and the removal of these accounts caused the plaintiffs' damages either by hastening Weis' demise or by removing assets which would have been available to the SIPC Trustee if these accounts had not been 'tipped'. The Exchange and Ladenburg as 'tippers' as well as their 'tippees' would be liable to the plaintiffs for any damages which they have suffered.

The plaintiffs in this case are not claiming that they too should have been 'tippees' as the defendants somehow led the court below to believe, and the principle of Levine v. Seilon, Inc. 439 F.2d 328 (2d Cir. 1971) that there is no right to share in improperly released information is inapplicable here.

The plaintiffs are not claiming that they too and they alone should have been 'tipped' so that they could remove their accounts from Weis prior to the SIPC liquidation. What the plaintiffs are saying is that the defendants had a duty to either disclose to everyone that Weis wished to have its margin customers transfer their accounts somewhere else or to tell no one. The

plaintiffs are simply reiterating the principle set forth by this court in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir., 1968). The principle of "disclose or abstain"; either tell everyone or tell no one, but don't tell just the chosen few.

This court's decision in Texas Gulf, supra similarly does away with the defendant's position and with the District Court's finding (JA-138a) that the defendants had acted to protect the public interest. If the defendants violated rule 10b-5 by disclosing material inside information to only a chosen few, the fact that this might have been undertaken in good faith in order to aid Weis is no defense for a violation of rule 10-b-5. In Texas Gulf, this Court specifically considered that contention and entitled Section D of its opinion "Is an insiders good faith a defense under Section 10-b-5?" (401 F.2d at 854), and in its opinion the court's answer to the question it had posed was a very clear No. The defendants' defense of good faith does not aid their position. If they violated rule 10-b-5, good faith is not a defense. Where the 1934 Act intended to make 'good faith' a defense, it specifically said so. See e.g. 15 U.S.C.78t.

It was a question for a jury to determine if the defendants had violated rule 10b-5 by releasing certain material inside information to a certain chosen few customers of Weis. It was not for the court below to determine, as a matter of law, that the defendants had not violated rule 10b-5 and they had acted in good faith; especially in light of the fact that there had been no evidence at all submitted by the defendants to support the decision of the court below. Neither the names of the owners of the accounts or the amounts in the accounts which were transferred from Weis to Ladenburg were made known to the court, and until that information was available, it was impossible for the Court to properly determine the motives behind the defendants' actions in 'tipping' certain large margin accounts to transfer their accounts from Weis prior to the SIPC liquidation. The very fact that it was only the very large accounts that were transferred should immediately raise a suspicion in the court's mind. In every securities fraud, it is the rich who profit and the small investor who is defrauded.

## CONCLUSION

The court below erred in granting the defendant's motion for summary judgment. There was no evidence submitted by the defendants in support of their motion for summary judgment which could support the court's findings and the materials which the court did rely upon in support of its findings were unacceptable and should not have been considered by the court on a motion for summary judgment. The question of whether or not the Exchange did or could have known of Weis' net capital violations prior to mid-April, 1973 and the defendant's purpose in transferring large margin accounts from Weis to Ladenburg prior to the SIPC liquidation are questions to be determined by a jury at a trial of this action.

The summary judgment motion before the court was based on a single ground that the plaintiffs had no provable damages and the plaintiffs had made it clear that they had not yet had discovery in order to defend

a summary judgment motion on the merits.

In light of these facts, summary judgment should not have been granted and the order of the court below dismissing the plaintiffs' complaint should be reversed.

Respectfully submitted,

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April 4, 1974

Re: Rich v. New York Stock Exchange

David Jaroslawicz, Esq.
Julien Blitz & Schlesinger, P.C.
2 Lafeyette Street
New York, New York 10007

Dear Mr. Jaroslawicz:

I return herewith the original transcript of the deposition of Robert Bishop. In view of the fact that the deposition has not been completed, we believe it would be improper to have Mr. Bishop execute the transcript at this time. Neither the Exchange nor Ladenburg Thalmann & Co. Inc. had an opportunity to cross-examine Mr. Bishop when his examination was adjourned. Accordingly, there may be areas which require elaboration or clarification.

Unless you advise us that this deposition of Mr. Bishop is completed, we shall withhold execution until the examination is carried to completion.

Very truly yours,

Richard C. Tufaro

Richard C. Tufaro

Enclosure

A 201 Affidavit of Service by Mail — LUTZ APPELLATE PRINTERS, INC.

US COURT OF APPEALS: SECOND CIRCUIT

RICH, et al,

- against -

NEW YORK STOCK EXCHANGE,

*Index No.*

*Affidavit of Service by Mail*

*STATE OF NEW YORK, COUNTY OF* *ss.:*

*I,* Karen Giles, *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 1013 East 180th Street, Bronx, New York
*That on the* 6TH *day of* January *1975, deponent served the annexed*

*upon* * *attorney(s) for*

*in this action, at* *

*the address designated by said attorney(s) for that purpose by depositing a true copy of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.*

*Sworn to before me, this day of* January 6th *1975.*

Karen Giles

KAREN GILES

* Finley, Kumble, Heine, Underberg & Grutman- 477 Madison Ave, New York, New Yprk

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975

* Milbank, Tweed, Hadley, & Mc Cloy Mc Cloy- 1 Chase Man. Plaza New York, New York

* Nickerson, Kramer, Lowenstein, Nessen, Kamin- 919 Third Ave., NY

* Lee Feltman, 295 Madison Ave., New York

* Geist, Netter, & Marks- 276 Fifth Ave., New York